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SUPREME COURT, U. S.

No. 539

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1961

THE PEOPLES BANK OF HAVERSTRAW,

Petitioner,

vs.

DAVID E. FELDMAN, AS TRUSTEE IN BANKRUPTCY OF GENERAL TEXTILE PROCESSORS,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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PETTION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Petitioner prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit entered in the above entitled case on August 18, 1961.

The Opinions Below

The opinion of the Court of Appeals below is reported at 293 F. 2d 889, and is appended hereto. The opinion of the District Court below (Southern District of New York) is reported at 185 F. Supp. 426, and appears at pages 7-26 of the Appendix of Plaintiff-Appellant-Appellee in the Court of Appeals.*

* A page reference to such Appendix is hereinafter preceded by "A", as "A 5". A similar reference to the Appendix of petitioner in the Court of Appeals (there called Defendant-Appellee) will be "E 5". A reference to the opinion of the Court of Appeals below will be to the pages of this petition, as "Op. 5a".

Jurisdiction

The judgment of the Court of Appeals was dated and entered on August 18, 1961. The jurisdiction of this Court is invoked under 28 U. S. Code, Section 1254 (1).

Questions Presented

Petitioner Bank had an account of the bankrupt. Prior to the filing of the bankruptcy petition, the name of the account was changed from that of the bankrupt to that of its treasurer. The treasurer then resigned his office. Thereafter the account was paid out on checks of the bankrupt signed by the treasurer. While this was going on, the petition in bankruptcy was filed. The Bank did not know of the resignation, or of the bankruptcy, until after the funds were paid out. The Court of Appeals held that the Bank has to pay to the bankrupt estate the amounts paid out after the filing of the bankruptcy petition, but not the amounts paid out before such filing, finding that the protection of Section 70d of the Bankruptcy Act is not available to the Bank.

The questions this Court is asked to consider are:

1. Did the Court of Appeals correctly construe Section 70d of the Bankruptcy Act?

2. Was the application by the Court of Appeals of that Section to this case correct?

3. Was the direction by the Court of Appeals for judgment herein correct?

Statutes Involved

The case involves principally Section 70d of the Bankruptcy Act (11 U. S. Code, Section 110 (d)), hereinafter re-

ferred to simply as Section 70d, which reads in pertinent part as follows:

> "(d) After bankruptcy and either before adjudication or before a receiver takes possession of the property of the bankrupt, whichever first occurs—
>
> • • •
>
> "(2) A person indebted to the bankrupt or holding property of the bankrupt may, if acting in good faith, pay such indebtedness or deliver such property, or any part thereof, to the bankrupt or upon his order, with the same effect as if the bankruptcy were not pending:
>
> • • •
>
> "(5) A person asserting the validity of a transfer under this subdivision shall have the burden of proof. Except as otherwise provided in this subdivision and in subdivision g of section 21 of this Act (section 44 of title 11), no transfer by or in behalf of the bankrupt after the date of bankruptcy shall be valid against the trustee: *Provided, however*, That nothing in this Act shall impair the negotiability of currency or negotiable instruments."

The Court of Appeals also cited Section 42 of the New York Negotiable Instruments Law, which reads as follows:

> "42. Forged signature; effect of
>
> Where a signature is forged or made without authority of the person whose signature it purports to be, it is wholly inoperative, and no right to retain the instrument, or to give a discharge therefor, or to enforce payment thereof against any party thereto, can be acquired through or under such signature, unless the party, against whom it is sought to enforce such right, is precluded from setting up the forgery or want of authority."

Statement of the Case

Federal jurisdiction in the District Court below was based upon the Bankruptcy Act and upon diversity of citizenship (plaintiff is a citizen of New Jersey, all defendants are citizens or corporations of New York) and amount.

The complaint contained nine causes of action against defendants other than petitioner, and judgment was granted to respondent thereon in amounts varying from over $80,000 to over $104,000; those defendants appealed but then withdrew their appeal (Op. 2a). There was one cause of action alleged against petitioner, which the District Court dismissed.

The proof adduced under the latter cause of action was as follows. On September 13, 1956, the bankrupt had opened an account with petitioner designed and thereafter used to meet its payroll (E 19, 4-10; A 28). Four officers were authorized to sign checks, including Koenig, the treasurer, who had actually opened the account and was well known to petitioner (E 19-20; A 33, 34-35). When the bankrupt's financial situation became dire on November 5, 1956, Koenig, in order to prevent misappropriation of the funds (then $20,160.81) by the other officers, changed the name of the account from the bankrupt's to his own, with the designation 'Special for Payroll". (E 7-8). Later that day, Koenig submitted his resignation as treasurer to the bankrupt (E 1, 3-4). During the several weeks thereafter, the regular payroll checks of the bankrupt, all signed by Koenig, were honored from the account upon Koenig's instructions, until the account was drawn down to $1.76. Meanwhile, on November 7, 1956, an involuntary bankruptcy petition was filed.

Petitioner Bank knew nothing of the financial distress of the bankrupt, or of the resignation of Koenig, or of the filing of the bankruptcy petition (E 12-14, Op. 4a). It acted in complete good faith. It may also be noted that the checks honored after November 5, 1956, were for payroll periods before that date (E 10).

The Court of Appeals held that petitioner is liable to the bankruptcy trustee for the amounts of all checks paid after the filing of the petition—$12,662.31. It declined to give petitioner the protection of Section 70d (2) because, it said, the payment was not on the order of the bankrupt but on the

order of Koenig who had by then resigned as treasurer, despite the lack of petitioner's knowledge of such resignation (Op. 7a). It ignored the fact that the checks so paid out would have been paid out in the same way if the name of the account had not been changed (E 14-15), and, presumably, such payment would not have been challenged by petitioner. The Court of Appeals concluded with a baffling (a characterization used by the dissenting Judge) indication that petitioner could recoup any funds directed to be paid the trustee which discharged the bankrupt's legitimate obligations (Op. 8a).

Argument

While the complaint seems to proceed on the theory that the change in the name of the account on November 5, 1956, from the bankrupt's to Koenig's was a conversion (Op. 4a), the Court of Appeals found that only a matter of form was involved, and that the funds always remained those of the bankrupt (Op. 5a). The Court of Appeals then found that these funds belonged to the trustee in bankruptcy on November 7, 1956, the date of filing of the bankruptcy petition; and that petitioner's paying out of these funds thereafter was not protected by Section 70d (2) as a payment in good faith upon the order of the bankrupt, because such order was given by Koenig who was no longer treasurer of the bankrupt, having resigned on November 5, 1956 (Op. 7a). This argument, it is believed, is clearly unsound.

Once a petition in bankruptcy is filed for a corporation, none of the corporate officers is authorized to act for it. The property of the corporation is in the custody and control of the court from the date of filing of the petition (4 *Collier on Bankruptcy* (14th ed.) p. 970). Then suppose a bank pays out in good faith on a corporate check signed by an officer duly authorized to sign before the filing. If the bank is protected in doing this by Section 70d(2), as paying upon the order of the bankrupt, such protection

exists because the order was given by one with apparent (rather than actual) authority to act for the bankrupt corporation. And it is immaterial whether the officer had or had not resigned. His apparent authority would be the same to a bank which had no knowledge of the resignation or of the bankruptcy.

The decision of the Court of Appeals has the effect of denying the above. That Court says that Koenig had no authority to give an order for the bankrupt. True, he had no actual authority, and this is so whether or not he had resigned. But he had apparent authority so far as petitioner was concerned, since petitioner did not know of his resignation or of the bankruptcy.

In short, the effect of the decision of the Court of Appeals is to require actual authority of one giving an order for the order to be valid under Section 70d (2); and this cannot exist in the case of an officer of a corporate bankrupt. It is believed that such cannot have been the intended effect of that Section.

(The argument of the Court of Appeals that petitioner relied upon Koenig's individual order is quite incomprehensible, since the Court held that the funds still belonged to the bankrupt, and the checks were those of the bankrupt signed by Koenig as treasurer. Moreover, the Court held valid checks honored on November 7, 1956, before the filing, but after Koenig's resignation; and if petitioner's reliance on Koenig as an authorized officer was valid on November 7, 1956, why was not such reliance valid thereafter?)

The decision of the Court of Appeals is erroneous in other respects. In the first place, it is believed that the transaction of November 5, 1956, constituted a transfer of the corporate funds to Koenig prior to the bankruptcy, a transfer which was for a proper purpose, not a conversion, and which gave Koenig power over the funds unhampered by the subsequent bankruptcy. Neither the District Court nor the dissenting Judge in the Court of Appeals found it necessary to consider this ground, finding that, in any event,

since the funds were used to satisfy the obligations of the bankrupt, it suffered no loss (A 25-26, Op. 10a).

The latter point is virtually ignored by the prevailing opinion of the Court of Appeals, and is another reason why such opinion is erroneous. The checks which were honored after November 7, 1956, were virtually all in payment of the legitimate payroll of the bankrupt for services before that date. It may be that the wage earners so paid received preferences; but all of the Judges below are agreed that petitioner is not responsible therefor (*Cunningham* v. *Merchants Nat. Bank*, 4 F. 2d 25 (C. C. A. 1st, 1925), *cert. den.* 268 U. S. 691 (1925)). If the bankrupt suffered no loss by reason of the payment out of its bank account by petitioner, how can petitioner be required to pay such account again? The prevailing opinion below says it does not pass upon petitioner's right to invoke remedies to recover funds used to pay the bankrupt's legitimate obligations; the dissent says that this comment is "baffling".

Finally, the decision of the Court of Appeals is erroneous in failing to give proper effect to Section 70d(5), which provides that nothing in the Bankruptcy Act shall impair the negotiability of negotiable instruments. The checks presented to petitioner had to be honored because, for the most part, they were presented by holders in due course—other banks which had given value to their depositors (the payees or endorsees of the checks). See *Rosenthal* v. *Guaranty Bank and Trust Company*, 139 F. Supp. 730 (W. D. La. 1956). The prevailing opinion below says that the checks had no valid inception since Koenig's signature thereon was not that of an authorized officer. However, the signature was that of an officer with apparent authority, which is as good for an innocent third party as actual authority.

* * *

Accordingly, it is respectfully submitted that this Court should grant certiorari because the Court of Appeals has decided several important questions of federal law which

have not been, but should be, settled by this Court. First, there is the question of the meaning and extent of protection to be afforded by Section 70d(2) and (5) of the Bankruptcy Act, which was enacted in 1938. Petitioner has been unable to find any decisions of this Court upon these matters. The inevitable effect of the decision below is to deny the protection of Section 70d(2) where the bankrupt is a corporation. (These matters relate to the first two questions posed *supra*, page 2).

Second, there is the question of whether a trustee in bankruptcy can recover a bank account used to pay the bankrupt's legitimate obligations. This question has never been answered by this Court. (This matter relates to the third question posed *supra*, page 2).

Both questions are of great interest to the business and financial community. The questions are presented here clearly, in a rather simple record, and on relatively undisputed facts. The decision below was thought to be of enough importance to warrant its publication on the front page of the New York Law Journal of October 24, 1961.

It may be noted that each of the four Judges who has thus far considered the case differed in his analysis; and, as to the result, two Judges thought petitioner should prevail, one thought respondent should prevail completely, and one thought respondent should prevail in part.

Conclusion

For the foregoing reasons, this petition for a writ of certiorari should be granted.

Respectfully submitted,

JOHN M. FRIEDMAN,
Counsel for Petitioner.

APPENDIX

Opinion

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 242—October Term, 1960.

(Argued February 21, 1961 Decided August 18, 1961.)

Docket No. 26486

DAVID E. FELDMAN, as Trustee in Bankruptcy of GENERAL TEXTILE PROCESSORS,
Plaintiff-Appellant,

—against—

CAPITOL PIECE DYE WORKS, INC., SAMUEL KOENIG and GILBERT KOENIG,
Defendants-Appellants,

and

THE PEOPLES BANK OF HAVERSTRAW,
Defendant-Appellee.

BEFORE:

HINCKS and MOORE, *Circuit Judges*, and BRENNAN, *District Judge*.*

Appeal from so much of a judgment of the United States District Court for the Southern District of New York, Frederick vP. Bryan, *Judge*, 185 F. Supp. 426, which dis-

* Sitting by designation.

missed the Trustee's action against The Peoples Bank of Haverstraw.

Reversed and remanded with a direction.

HARPER & MATTHEWS, *Attorneys for Plaintiff-Appellant*, 70 Pine Street, New York 5, N. Y. (Harold Harper and Arthur R. Gaetjens, on the brief).

JOHN M. FRIEDMAN, *Attorney for Defendant-Appellee*, 50 East 42nd Street, New York 17, N. Y.

BRENNAN, *District Judge:*

This appeal challenges the validity of a judgment of the District Court for the Southern District of New York which dismissed the claim of the trustee against The Peoples Bank of Haverstraw, hereinafter referred to as the "bank."

The complaint advanced ten separate claims against individual and corporate defendants. These claims, all arising out of the tangled background of the business affairs of the bankrupt, were tried to the court and money judgments were awarded against the Capitol Piece Dye Works, Inc., hereinafter referred to as "Capitol," and the individual defendants. The appeals taken from such judgments were withdrawn and we are not concerned therewith. The factual background applicable to the sole judgment under attack here will be briefly set forth.

The General Textile Processors, the bankrupt, was incorporated in New Jersey June 1, 1956. It came into being as the result of the amalgamation of seven corporations operating their separate plants in New York and New Jersey. These corporations were faced with financial loss in their separate businesses due to economic conditions in the business of finishing and dyeing of textiles in which they were engaged.

Capitol was one of the participating companies in forming the bankrupt as above. It operated a plant near Garnersville, N. Y. which was leased to the bankrupt in accordance with the agreement of amalgamation. Samuel Koenig was the president of Capitol and was also the treasurer and a director of the bankrupt.

On September 13, 1956, the bankrupt opened an account in the Peoples Bank of Haverstraw. The account was used primarily to meet the payroll of the Capitol plant. The arrangements for said account were made by Koenig who had been a valued customer of the bank for several years. Any one of four officers of the bankrupt, including Koenig, was authorized by a so-called signature card to sign checks drawn upon said account.

The business operations of the bankrupt were financially unsuccessful. The chronological history pertinent here may be summarized as follows. On September 21, 1956, the bankrupt was insolvent; on November 2, 1956 it discontinued business; on November 5, 1956, an application for an equity receiver of the bankrupt was made to a New Jersey court; an order was filed appointing a receiver on November 7, 1956 and on the same day, an involuntary petition in bankruptcy was filed against the bankrupt in the United States District Court for New Jersey; on November 26, 1956, an order of adjudication was entered; on March 19, 1957, the plaintiff was appointed trustee.

The above facts afford a background for an understanding of the transactions which are the bases of the trustee's claim involved here, the circumstances of which are summarized below.

On November 5, 1956, the balance in the bankrupt's account in the bank was $10,660.81. On the morning of the above date, Koenig deposited in said account a check payable to the bankrupt in the amount of $9500. After ascertaining, through the assistance of bank personnel, that the check was good, Koenig then drew a check to his own order for the total balance in the account in the amount of $20,160.81. The check was immediately deposited in the

bank in a new account entitled "S. Koenig, Special for Payroll." Koenig was the only person authorized to make withdrawals from said account. It was under his sole control. In the afternoon of the same day, Koenig submitted to the bankrupt his written resignation as treasurer.

Thereafter and intermittently from November 7, 1956 to November 26, 1956, checks drawn upon the bankrupt's account and signed by Koenig were presented to the bank. For the most part, they represented payroll payments for the employees at the Garnersville plant. Some of said checks were drawn prior to November 5, 1956 and signed in behalf of the bankrupt by S. Koenig. Those checks, drawn after that date, were signed in like manner. Upon presentation of such checks, the bank received the oral authorization of Koenig to pay same from the "S. Koenig, Special for Payroll" account. On November 26, 1956, prior to the time when the bank was informed that an adjudication had been made and a receiver had been appointed for the bankrupt, all of the funds in said account had been withdrawn with the exception of something less than $2.00.

The trustee's action appears to be based upon alternative contentions that the bank's action or inaction in the above transactions constitute a misapplication of the bankrupt's funds, a negligent and fraudulent transfer thereof and a breach of the bank's obligation to its depositor—all of which were put in issue in the trial court.

After taking evidence, which consisted in part of the oral testimony of Koenig and an officer of the bank who possessed knowledge of the facts relative to the transfer of the account and the subsequent handling thereof, the court made its decision which failed to make a specific finding as to wrongful conduct on the part of the bank as a basis of its liability.

The court found that the bank had no knowledge of the financial condition of the bankrupt during the crucial period involved. "It had no knowledge of bankruptcy, insolvency, the appointment of a receiver or financial failure." The obligation of the bank in the matter of the

handling of corporate funds was briefly discussed. The court concluded that in any event no loss was sustained by the bankrupt corporation and therefore no liability followed. This conclusion is based upon an assumption rather than a finding that the bank breached its obligation to the bankrupt by permitting the transfer of November 5th.

Since the evidence is substantially undisputed, we are in as good a position as the trial court to make the necessary evaluation thereof as a basis for the decision of the questions posed. *Orris* v. *Higgins*, 180 F. 2d 537.

A determination of the nature and effect of the transaction of November 5, 1956 is essential in this controversy. It is noted that the trial court did not find that the transfer of the account on the above day to "S. Koenig, Special for Payroll" amounted to a conversion thereof. The background of the transaction would seem to lend force to the conclusion that the transaction was one of form rather than of substance. Koenig knew that one of the officers of the bankrupt, who had authority to draw checks upon the bankrupt's account involved here, had withdrawn substantial sums of money from another of the bankrupt's bank accounts at Paterson, N. J. Koenig consulted his attorney as to what he could do, in the event of bankruptcy, to insure that the moneys in the appellee's bank could be protected so that employees would receive their pay. An excerpt from his testimony follows:

> "He says, 'They can attach the account right away and the people will not get their pay.'
>
> "I says, 'What can I do?' I says, 'Can I withdraw that money to save it for the people?'
>
> "He says, 'Yes,' and he gave me the suggestion what to do."

Koenig further testifies without contradiction that he told the bank officer who attended to the details of the transaction that all payrolls as they usually come from the bankrupt should be paid from the new account. It is also noted that the action brought against Koenig was based upon his creation of illegal preferences in the matter of

the funds involved here rather than a conversion thereof and that the new account was in fact used in payment of compensation to employees of the bankrupt. All of the above dictates a finding that the transaction of November 5, 1956 did not divest the bankrupt from the ownership of the funds in the bank at that time and the same constituted a change of name in the account rather than a transfer of the title thereto.

Upon the above finding, it follows that the ownership of the account remained in the bankrupt until November 7, 1956 when the petition in bankruptcy was filed and the bankrupt incurred no loss on account of the cashing of checks in the amount of $7,497.14, drawn prior to the filing of the petition in bankruptcy and presented to the bank between November 5, 1956 and November 7, 1956. Preference may have been made, but this action is not based upon such a claim and the bank is not liable therefor when it honors depositor's checks without notice of his insolvency. *Cunningham* v. *Merchants Nat. Bk.*, 4 F. 2d 25.

The above holding does not dispose of the whole controversy but the problem becomes one of applying the pertinent provisions of the Bankruptcy Act.

Section 70 of the Act, 11 U. S. C. 110, vests the trustee with the title to the bankrupt's assets as of the date of the filing of the petition, which would be November 7, 1956. It further provides that no transfer by or in behalf of the bankrupt shall thereafter be valid unless it comes within the protective provisions of the section. The trustee contends that the payment by the bank of the checks presented after the filing of the petition from the account constitutes an invalid transfer of the assets.

The bank invokes the provisions of Sections 70d.(2) and (5) of the Act which it contends affords the bank protection from liability for the payment of checks aggregating $12,662.31 paid by the bank after November 7 and prior to any knowledge on the part of the bank as to the pending bankruptcy and also prior to the actual adjudication. We

hold that the bank's reliance upon the above provisions is misplaced.

The applicable law requires no lengthy discussion. The history of the section involved, its interpretation and application are discussed in *Lake* v. *N. Y. Life Ins. Co.*, 218 F. 2d 394. More recently, in *Kohn* v. *Myers*, 266 F. 2d 353, the policy of the statute is said to place an absolute ban upon all transfers not given specific protection under the Act. Good faith, absence of advantage to the transferor or non-depletion of the assets of the estate do not affect the effectiveness of the ban. We proceed to apply the law to the facts disclosed.

Koenig resigned as an officer of the corporation on November 5. He had no actual authority thereafter to sign checks payable from the bankrupt's funds. It may be argued that the bank had the right to rely upon the apparent authority of Koenig until it was notified by the bankrupt of his resignation as an officer. However that may be, the bank in making payments did not rely thereon but in each instance sought and acted upon the oral, individual and personal authorization of Koenig to charge the special account with the checks involved. It therefore cannot be said that the bankrupt's indebtedness, represented by such checks, was paid "upon his (the bankrupt's) order" as provided in Section 70d.(2) and the transfers are not protected by the above provision.

Section 70d.(5) is likewise unavailable to protect the involved transactions. The section in effect imposes the burden of proof as to the validity of transfers upon the party asserting same and provides that the negotiability of currency or negotiable instruments is not impaired by the provisions of the Act. The series of checks with which we are presently concerned had no valid inception since they lack the signature of an authorized officer. They are therefore "wholly inoperative" and confer no right upon the bank "to give a discharge therefor." N. Y. Neg. Instruments Law, Sect. 42.

We conclude that the judgment appealed from must be reversed and the matter remanded to the District Court for the entry of a judgment for the trustee in the amount of $12,662.31 with interest from November 26, 1956 in accordance with this decision. We do not however pass upon the right of the bank to invoke any remedies which it may consider to be available to recover that portion of the funds, represented by the judgment to be entered, which have been used in the payment of the bankrupt's legitimate obligations.

Reversed and remanded with a direction.

HINCKS, *Circuit Judge*, concurring in part and dissenting in part:

I concur in the award to the Trustee of $12,662.31 with interest and the grounds on which the award is made.

I dissent from the holding that the Trustee is not entitled, in addition to the award as made, to recover with interest the sum of $7,497.14 representing the amount of checks presented to the Bank and paid by it between November 5 and November 7, 1956. I would hold that the transaction of November 5, 1956 was a transfer of a corporate bank account made by a corporate officer to himself individually without actual authority not in the due course of the Bank's business and under circumstances which put the Bank on inquiry as to the underlying authority for the transfer. In my opinion, the Bank was not absolved by § 95 of the Negotiable Instruments Law of New York which in express terms is applicable only when "such bank • • • have on file an authorization from said corporation showing that the said officer • • • is authorized on behalf of the corporation" to draw checks against the account of such corporation to himself as payee. Here, the only authorization on file was "to recognize • • • the signatures" of the four general officers of the corporation. This was not enough to satisfy the proviso, quoted above, to the exculpatory clause of said § 95. *Commercial Trading*

Co. v. Trade Bank & Trust Co., 286 App. Div. 722, 146 N. Y. S. 2d 570.

◇

MOORE, *Circuit Judge* (dissenting):

Plaintiff, Trustee in Bankruptcy for General Textile Processors (General), is seeking to recover from defendant, The Peoples Bank of Haverstraw (the Bank), the *funds* which General had on deposit in Peoples. According to plaintiff, the funds had wrongfully been transferred by S. Koenig, an officer of General, from the General payroll account to an account labelled "S. Koenig Special for Payroll." After the transfer, payroll checks mostly drawn previously on the General account to the order of a number of General employees continued to be presented to the Bank. The General account having been closed, there were no funds therein. At the direction of Koenig, these checks were paid out of the newly created "S. Koenig Special for Payroll" account. The crucial dates are:

Sept. 21, 1956	General insolvent (unknown to the Bank).
Nov. 5, 1956	General's account transferred by Koenig to "S. Koenig Special for Payroll."
Nov. 5, 1956	Complaint for the appointment of receiver presented to New Jersey court (unknown to the Bank).
Nov. 5, 1956	Koenig resigned as treasurer of General (unknown to the Bank).
Nov. 7, 1956	Petition in Bankruptcy filed (unknown to the Bank.)
Nov. 7th through 26th, 1956	Checks (some dated before November 5th, and some dated after) drawn against General's account, paid out of the "S. Koenig Special for Payroll" account. Special account reduced from $20,160.81 to $1.76.
Nov. 26, 1956	The Bank notified of bankruptcy of General.

The court below held that even if the Bank breached its obligation to General by permitting the transfer, it would be liable only for the loss actually incurred by the corporation; and since the transferred funds were used for legitimate corporate obligations and since the payroll checks would have been paid out of the General account even if the transfer had not occurred, no such loss existed.

Discussion of the case on this hypothesis is unnecessary in view of the trial court's findings of fact. Although the findings are gleaned from the narrative opinion, they are nonetheless findings and the court made the appropriate designation to that effect.

Under the law the Bank would be liable only if corporate funds were withdrawn by a corporate officer and used for his own purposes with actual or constructive knowledge by the Bank that this would occur. *Bischoff* v. *Yorkville Bank*, 218 N. Y. 106; *Commercial Trading Co.* v. *Trade Bank & Trust Co.*, 286 App. Div. 722; *E. Mock Co.* v. *Security Bank of New York*, 176 App. Div. 842, aff'd 225 N. Y. 723. And then such liability would attach only for the amount of the loss.

The determinative facts must be those which bear upon "actual or constructive knowledge to the Bank." The court found that "the receiver never communicated with the Bank or attempted to take possession of the bankrupt's funds"; that the Bank "had no knowledge of bankruptcy, insolvency, the appointment of a receiver, or financial failure"; that the funds in the "S. Koenig Special for Payroll" account were used "for legitimate corporate obligations of the bankrupt"; and that "checks drawn against the Special Payroll account were checks of the bankrupt." As to loss, there was no proof that the funds had been "diverted from legitimate corporate purposes." The undisputed facts affirmatively established that the funds had been used for corporate purposes. "Any loss or damage which occurred was to other priority wage creditors because of the preference obtained by other creditors of the same class but the Bank "is not liable for any loss which

may have been suffered by creditors because of preferential payments made in satisfaction of legitimate corporate obligations.'"*

A reviewing court is thus met with the "clearly erroneous" rule. Even this rule scarcely applies because no different findings could have been supported. The majority finds a failure on the part of the trial court "to make a specific finding as to wrongful conduct on the part of the bank as a basis of its liability." Exactly how this could have been done by a court convinced that there was no wrongful conduct is not revealed. The majority opinion seems to recognize this in its own "finding that the transaction of November 5, 1956, did not divest the bankrupt from the ownership of the funds in the bank at that time and the same constituted a change of name in the account rather than a transfer of the title thereto." Therefore, the opinion holds that "ownership of the account remained in the bankrupt until November 7, 1956, when the petition in bankruptcy was filed." Attention, thus, must be focused on the legal situation as it existed on November 7, 1956. The account, according to the majority, was still in Capitol; S. Koenig, despite his resignation, so far as the Bank was concerned was still the Treasurer; and because no notice of bankruptcy had been received, the funds of Capitol were not under restraint. The same reason given by the majority for holding valid the checks paid before November 7th would apply equally well to the checks drawn thereafter but for the bankruptcy petition. However, the proof is unchallenged that the Bank had no notice of the petition.

Section 70d(2) of the Bankruptcy Act provides:

> "(2) A person indebted to the bankrupt or holding property of the bankrupt may, if acting in good faith, pay such indebtedness or deliver such property, or any part thereof, to the bankrupt or upon his order, with the same effect as if the bankruptcy were not pending;"

* Quotations from opinion below.

To take this protection away from the Bank, the majority rely upon Koenig's resignation on November 5th, of which the Bank had no notice. This fact they avoid by the fact that the Bank acted on the "oral, individual and personal authorization of Koenig to charge the special account with the checks involved." The conclusion is that the checks were not paid "upon his (the bankrupt's) order" (Sec. 70d(2)). But this result is completely at variance with the majority's new finding that the transaction of November 5, 1956, did not divest the bankrupt of ownership. A relationship of debtor and creditor must, therefore, have continued and the "Special Account" theory has no factual support. Furthermore, the very same type of authorization used to justify the payment of the $7,497.14 applies equally to the $12,662.31.

The proposed judgment is also baffling because if the Bank may proceed to recover "that portion of the funds, represented by the judgment to be entered, which have been used in the payment of the bankrupt's legitimate obligations," why cannot the trial court on the remand determine as it has already done that all checks were honored for such purpose? What then becomes of the Trustee's judgment?

Upon the facts here presented, I believe the trial court's conclusion to be in conformity with the applicable principles of law and, hence, I would affirm.

Judgment of Court of Appeals

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Courthouse in the City of New York, on the eighteenth day of August one thousand nine hundred and

PRESENT:

HON. CARROLL C. HINCKS,
HON. LEONARD P. MOORE,
Circuit Judges

HON. STEPHEN W. BRENNAN,
District Judge

DAVID E. FELDMAN, AS TRUSTEE IN BANKRUPTCY OF GENERAL TEXTILE PROCESSORS,
Plaintiff-Appellant,

v.

CAPITOL PIECE DYE WORKS, INC., SAMUEL KOENIG, AND GILBERT KOENIG,
Defendants-Appellants
THE PEOPLES BANK OF HAVERSTRAW,
Defendant-Appellee.

Appeal from the United States District Court for the District of New York.

The cause came to be heard on the transcript of record from the United States District Court for the Southern District of New York, and was argued by counsel.

On Consideration Whereof, it is now hereby ordered, adjudged, and decreed that the judgment of said District Court be and it hereby is reversed and that the action be and it hereby is remanded for the entry of a judgment for the trustee in the amount of $12,662.31 with interest from November 26, 1956 in accordance with the opinion of this Court; with costs to the plaintiff appellant.

A. Daniel Fusaro
Clerk